Rev. Proc. 94-57, 1994-2 CB 744--IRC Sec(s). 42

August 24, 1994

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability. (Also Part I, sections 42; 1.42-13(a).)

1. PURPOSE

This revenue procedure informs owners of qualified low-income housing projects and housing credit agencies (Agencies) when the gross rent floor in section 42(g)(2)(A) of the Internal Revenue Code takes effect.

2. BACKGROUND

On May 5, 1993, new area median gross income (AMGI) figures went into effect for the United States Department of Housing and Urban Development programs and other federal programs that use AMGI figures, including the section 42 low-income housing tax credit program. In some areas, the AMGI level fell below previous levels.

Section 42(g)(1) defines a qualified low-income housing project as any project for residential rental use that meets one of the following requirements: (A) 20 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 50 percent or less of AMGI, as adjusted for family size, or (B) 40 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 60 percent or less of AMGI, as adjusted for family size.

Section 42(g)(2)(A) provides that, under section 42(g)(1), a residential unit is rent-restricted if the gross rent for the unit does not exceed 30 percent of the imputed income limitation applicable to the unit. Under section 42(g)(2)(C), the imputed income limitation applicable to a unit is the income limitation that would apply under section 42(g)(1) to individuals occupying the unit if the number of individuals occupying the unit were as follows: (i) in the case of a unit that does not have a separate bedroom, one individual, or (ii) in the case of a unit that has one or more separate bedrooms, 1.5 individuals for each separate bedroom.

For calculating gross rent on a rent-restricted unit, section 7108(e)(2) of the Revenue Reconciliation Act of 1989, 1990-1 C.B. 214, 220, amended section 42(g)(2)(A) to provide that the amount of the income limitation under section 42(g)(1) applicable for any period is not less than the limitation applicable for the earliest period the building that contains the unit was included in the determination of whether the project is a qualified low-income housing project (the gross rent floor). Section 42(g)(3)(A) provides that, except as otherwise provided in section 42(g)(3), a building is treated as a qualified low-income building only if the project (of which the building is a part) meets the requirements of section 42(g)(1) not later than the close of the first year of the credit period for the building.

Section 42(h)(1)(A) provides that the amount of credit determined under section 42 for any taxable year for any building shall not exceed the housing credit dollar amount allocated to the building under section 42(h). Under section 42(m)(2)(A), the housing credit dollar amount allocated to a project shall not exceed the amount an Agency determines is necessary for the

financial feasibility of the project and its viability as a qualified low- income housing project throughout the credit period. Section 42(m)(2)(B) provides that in making the determination under section 42(m)(2)(A), an Agency shall consider (i) the sources and uses of funds and the total financing planned for the project, (ii) any proceeds or receipts expected to be generated by reason of tax benefits, (iii) the percentage of housing credit dollar amounts used for project costs other than the cost of intermediaries, and (iv) the reasonableness of the developmental and operational costs of the project. The gross rent under section 42(g)(2)(A) that a low-income housing project may generate is a source of funds an Agency must consider in making the determination under section 42(m)(2)(A).

Section 42(h)(4)(A) provides that section 42(h)(1) does not apply to the portion of any credit allowable under section 42(a) that is attributable to eligible basis financed by any obligation the interest on which is exempt from tax under section 103 if (i) the obligation is taken into account under section 146, and (ii) principal payments on the financing are applied within a reasonable period to redeem obligations the proceeds of which were used to provide the financing. Section 42(h)(4)(B) provides that for purposes of section 42(h)(4)(A), if 50 percent or more of the aggregate basis of any building and the land on which the building is located is financed by an obligation described in section 42(h)(4)(A), section 42(h)(1) does not apply to any portion of the credit allowable under section 42(a) for the building. Section 42(m)(2)(D) provides that section 42(h)(4) does not apply to any project unless the governmental unit that issued the bonds (or on behalf of which the bonds were issued) makes a determination under rules similar to the rules of section 42(m)(2)(A) and (B). Upon making this determination, an Agency will issue a "determination letter" to a building.

Under section 1.42-13(a) of the Income Tax Regulations, the Secretary may provide guidance through various publications in the Internal Revenue Bulletin to carry out the purposes of section 42.

3. SCOPE

This revenue procedure applies to Agencies and owners of qualified low-income housing projects, as defined by section 42(g)(1).

4. PROCEDURE

Except for a low-income building described in section 42(h)(4)(B) (a bond-financed building), the Internal Revenue Service will treat the gross rent floor in section 42(g)(2)(A) as taking effect on the date an Agency initially allocates a housing credit dollar amount to the building under section 42(h)(1). However, the Service will treat the gross rent floor as taking effect on a building's placed in service date if the building owner designates that date as the date on which the gross rent floor will take effect for the building. An owner must make this designation to use the placed in service date and inform the Agency that made the allocation to the building no later than the date on which the building is placed in service.

For a bond-financed building, the Service will treat the gross rent floor in section 42(g)(2)(A) as taking effect on the date an Agency initially issues a determination letter to the building. However, the Service will treat the gross rent floor as taking effect on a building's placed in service date if the building owner designates that date as the date on which the gross rent floor

will take effect for the building. An owner must make this designation to use the placed in service date and inform the Agency that issued the determination letter to the building no later than the date on which the building is placed in service.

An Agency should establish a procedure that will allow an owner to inform the Agency of this designation no later than the date the owner's building is placed in service.

For the effect of a change in AMGI on the initial qualification of a tenant as a low-income tenant and the available unit rule, see Rev. Rul. 94-57.

5. EFFECTIVE DATE

This revenue procedure is effective for low-income housing projects receiving initial allocations or determination letters issued after * . For those projects that received initial allocations or determination letters prior to this effective date, for purposes of establishing the gross rent floor in section 42(g)(2)(A), owners and Agencies may use a date based on a reasonable interpretation of section 42